United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7288

IN THE

United States Court of Appeals

For The Second Circuit

NATHAN CHANOFSKY,

Plaintiff-Appellant,

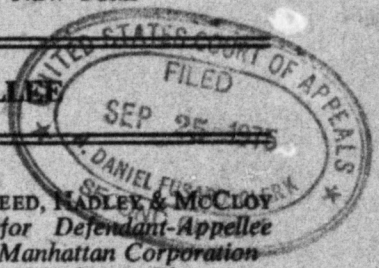
against

THE CHASE MANHATTAN CORPORATION,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLEE



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Statement of Issue Presented for Review

Did plaintiff raise any issue of fact on the question of whether he was damaged by the alleged misrepresentations so as to preclude summary judgment?

Statement of the Case

Plaintiff appeals from a decision and judgment of the United States District Court for the Southern District of New York (Duffy, J.) (101-110a*) granting summary judgment in favor of defendant ("Chase").

* "a" refers to the Appendix.

The complaint (6a-16a) alleges that in August, 1974, plaintiff purchased five Chase 6½% convertible subordinated debentures (the "debentures"), which he continues to hold. Plaintiff claims that in connection with this investment, he was damaged by material misstatements and omissions in two consolidated earnings statements issued by Chase in May and July, 1974, in alleged violation of § 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. The action is alleged to be brought on behalf of an alleged class of "all persons who purchased equity securities of . . . [Chase] in the open market from on or about May 10, 1974 to and including October 4, 1974." (6a) Chase's motion for summary judgment was brought on prior to any determination on the class action question.

The complaint asserts that the market prices of the debentures were "artificially inflated" as a result of Chase's misstatement of its earnings, and that they "declined to their true values" when "the misleading statements . . . were revealed" by Chase on October 2, 1974. (15a) No claim is made that plaintiff relied on the alleged misstatements.

Chase moved for summary judgment on the grounds that at all relevant times the market prices of the debentures reflected no equity characteristic; that the alleged misstatements were not material to a purchaser or holder of the debentures; and that plaintiff had not been damaged. On the motion, both sides submitted various market statistics on the price behavior of the debentures and comparable securities. At the hearing on the motion, both parties waived trial by jury (88a, 89a), stipulated to the facts (101a), and the matter was marked submitted. (94a) By memorandum decision dated March 21, 1975, the District Court found that plaintiff's damage claim was "based on the purest of speculation" and that "[a]ny damages

awarded would have to be based on mere speculation, guess or conjecture." (108a) Finding no damage, the Court directed judgment for Chase.

The Facts

The relevant facts with respect to the alleged misstatements were publicly disclosed by Chase and are set forth in its moving affidavit (22a, 27a-38a). Chase is a bank holding company. Its principal subsidiary, The Chase Manhattan Bank, N.A. (the "Bank"), maintains an inventory of securities in connection with its bond trading activities. In accordance with the Bank's established accounting guidelines, portions of that inventory (such as municipal bonds) are carried on its books at the lower of cost or market value. Fluctuations in the book value of that inventory are reflected in Chase's earnings on a periodic basis, notwithstanding the fact that the inventory represents no realized gain or loss.

On October 1, 1974, the Bank's senior management discovered that these accounting guidelines had not been followed and that certain securities had been recorded on the books in excess of a reasonable estimate of market value (but no higher than cost). Prompt disclosure was made by Chase on October 2 of the amount by which bond inventory appeared to exceed the accounting guidelines—approximately $34 million out of an $800 million total inventory (27a)—and Chase's reported earnings for the first two quarters of 1974 were restated accordingly on October 10. (30a) During the period encompassing these two announcements, the market prices of the debentures, at

the close of trading on the New York Stock Exchange (70a), were:

October	1	69¾
	2	69½
	3	68¼
	4	67
	7	69½
	8	69
	9	70
	10	72
	11	72

On October 7, 1974 (prior even to Chase's announcement of its restated earnings), plaintiff commenced this action as a holder of five of the debentures, claiming that he had been damaged by reason of the original earnings reports issued by Chase in May and July. Plaintiff does not claim that he considered those reported earnings in connection with his decision to purchase the debentures or that had the overvaluation been known he would not have purchased them. Rather, plaintiff's argument is solely that the market prices of the debentures were "artificially inflated" (15a) as a result of the public dissemination of earnings reports based upon incorrect valuations.

This inadvertent overvaluation and its prompt correction are, however, wholly immaterial to the price or value of the debentures. (23a-24a) Although "immediately convertible" into common stock of Chase, the debentures are convertible only at a conversion price of $57.50 per share. At no time during the relevant period did the market price of Chase's common stock exceed or even approach this conversion price. Under the conversion formula, any debenture holder seeking to convert would have had to pay a substantial premium above the price at which he

could purchase the common in the market place, *i.e.* between $12.96 and $8.43 in excess of the market price. There was, in fact, no conversion of the debentures by any holder during this period. Nor has there ever been any doubt of Chase's ability to meet all of its financial obligations under the debentures. (24a)

Accordingly, the market prices of the debentures have been wholly unrelated to the earnings, or reported earnings, of Chase. Rather, those prices have fluctuated in accordance with prevailing interest rates and the normal variations of an auction market. On the motion, plaintiff submitted the affidavit of Mark L. Sontag, a registered representative, as expert testimony. (76a-77a) Sontag admitted that the only discernible market movement of the debentures following Chase's October 2 announcement was "wholly within the expected range of price variances which frequently occur on a short term basis . . . [and] result from the normal dynamics of the market." Indeed, shortly after the announcement, when the prices of the debentures are alleged to have "substantially declined", those prices in fact rose five points to a high of 72 by October 11, and then continued on a steady ascent, reaching 83 a few months later. (64a)

During the period from May through September 1974, when the prices of the debentures are alleged to have been "artificially inflated" as a result of erroneous earnings statements, those prices in fact declined from 88½ to 69¾. Thus, during the three-day periods following the alleged publication dates of the two asserted misrepresentations (which plaintiff suggested as an appropriate measure of "market reaction"), the prices of the debentures *dropped* a total of 5½ points: down 4, from May 9 to May 13, 1974; and down 1½ from July 25 to July 29, 1974. (61a, 69a)

The largest price decline which plaintiff was able to find, following Chase's October 2 announcement, was a 2¾ point drop from October 1 to October 4. On October 7, the next trading day, the price rose by 2½ points.

Price fluctuations in these amounts have occurred many times in the market history of the debentures. Movements of 2 or more points over a period of three or four days have taken place at least 71 times in the past three years, *i.e.*, about twice a month. Such variations in debenture prices *for a single day* are not uncommon and have occurred no less than 30 times since January, 1973. Indeed, the price of the debentures dropped by 2⅛ points the very day after plaintiff's alleged purchase, for no apparent reason. (62a, 69a)

Summary of Argument

The District Court's finding—that plaintiff had no provable damages—is amply supported by the record, in particular the stipulated daily market prices of the debentures. Plaintiff failed to come forward with evidentiary facts raising a genuine issue of fact. Under the applicable law, dismissal was appropriate.

ARGUMENT

I.

The District Court's Determination of No Damage is Based on Stipulated Facts and is in Accord with the Applicable Law.

Plaintiff argues that "expert opinions" may explain away the undisputed market prices which refute the allegations of his complaint. Yet, plaintiff submitted Sontag's

affidavit as expert testimony and Sontag was unable to quantify any damage whatsoever. Sontag postulated some unspecified "negative effect" resulting from Chase's October 2 announcement (but, significantly, not from the facts disclosed by the announcement), while explicitly admitting that the variations in market prices fall wholly within the range of expected daily market price variances. The District Court properly treated plaintiff's claim of damage as "based on mere speculation, guess or conjecture."

Proof of damage is an essential element of any Rule 10b-5 claim. In opposing a motion for summary judgment, plaintiff must bear at least the burden of demonstrating that such proof exists and that measurable damage can be shown. *Levine* v. *Seilon, Inc.*, 439 F.2d 328, 335 (2d Cir. 1971). The failure to show some "actual damage" is a fatal defect in a claim based on the Exchange Act, and "it is well-established that a plaintiff is not entitled to an award of damages unless both the fact of damage and the amount of damage are established with reasonable certainty; neither may properly be based upon mere speculation, guess, or conjecture." *Zirin Lab. Int'l, Inc.* v. *Mead-Johnson & Co.*, 208 F. Supp. 633, 635 (E.D. Mich. 1962); *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962).

The District Court had before it not merely affidavits of the parties, but stipulated evidentiary facts presenting comprehensively and conclusively the day-by-day market prices and their fluctuations upon which plaintiff bases his claim for damages. Even plaintiff's own proffered "expert" was utterly unable to determine the fact or amount of damage, because he could not distinguish the post-announcement price variations of the debentures from the price variations which occurred throughout.

On the facts before the Court, it is not necessary to take issue with the measure of damages set forth by plaintiff in Point II of his brief. On appropriate facts, an unambiguous market reaction to the disclosure of material misrepresentations may be a proper indication of Rule 10b-5 damages previously incurred by a purchase on the open market. The fact of the matter is, however, that no such "reaction" is apparent here.

Had plaintiff awaited the report of restated earnings, released by Chase on October 10, he would have seen that the market price of the debentures already had risen from 67 (on October 4) to 72. The temporary previous decline which he singles out was matched by the declining prices of debentures of other bank holding companies during the same period (61a), and is, in any event, utterly insignificant in duration or amount in light of the price history of the debentures. Far from indicating a market reaction to Chase's announcement of October 2, the price behavior immediately afterward shows the absence of any such effect.

To suggest that plaintiff, having held on to the debentures, may prove damage by pointing to other securities, would make the trial of this issue a feckless exercise in speculation. It is well-settled that Exchange Act liability "does not include the expectant fruits of an unrealized speculation." *Estate Counseling Service, Inc.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc., supra,* at page 533. The District Court's rejection of this argument was entirely proper. As recognized by this Court in *Lowenschuss* v. *Kane,* CCH Fed. Sec. L. Rep. ['74-'75 Decisions] ¶ 95,104 at 97,925 (2d Cir. May 27, 1975):

> "Damages cannot be based upon mere speculation or guesswork. . . . To recover anything the class members must assume the burden of proving [them] with reasonable certainty."

Comparison of the debentures to other securities claimed to be comparable as a method of showing "out-of-pocket" damage was properly characterized by the District Court as the purest of guesswork. No case cited by plaintiff holds that market reaction, itself an imperfect measure of damage, may be proven to a reasonable certainty by this type of comparison. In any event, the evidentiary facts upon which plaintiff proposed to rely were presented to the District Court, and stipulated to by the parties. The testimony of plaintiff's proffered "expert" was received by the Court. Under the applicable principles of law, no issue of fact was raised.

Plaintiff argues (Br. 21) that it was error for the District Court to consider the miniscule amount of the overvaluation when compared to Chase's total assets. Such a comparison, however, was entirely appropriate on the issue of materiality. It was from Chase's assets that interest would be paid on the debentures and their ultimate redemption effected. On the other hand, the diminution in Chase's earnings caused by factoring in the amount of the overvaluation could have no effect on the market prices of the debentures because the large conversion premium precluded the debentures trading as an equity security at any time during the relevant period.

Plaintiff's new argument—that Chase has somehow reaped a "windfall profit" by reason of the overvaluation —is preposterous. Chase did not sell the debentures to plaintiff, nor stand to profit in any way from their market prices after original issuance. Plaintiff's argument, in essence, is that although he has suffered no demonstrable damage, the alleged "wrongdoer" should not be permitted to escape any penalty for its actions. It is plain from the record (22a) that Chase was every bit as misled as plaintiff with respect to the facts here involved, and that no

judicial sanction is required to insure against repetition. In any event, there is no basis in the Exchange Act for the recovery of anything other than "actual damage", and plaintiff's attempt to create a new remedy to encompass what could only be punitive damages is wholly without support. See *Eisen* v. *Carlisle & Jacquelin*, 479 F.2d 1005, 1013 (2d Cir. 1973), *vacated on other grounds*, 417 U.S. 156 (1974).

The District Court's decision that plaintiff, as a purchaser and holder of the debentures, suffered no provable damage by reason of the events complained of, is supported by the evidence and the law. The result reached by the District Court is the proper outcome. The dicta in the District Court's memorandum decision with respect to prices which are "grossly unfair", and plaintiff's lack of out-of-pocket loss, are just that. On the facts of this case, this Court need have no concern that the decision below will be erroneously interpreted, in the manner urged by plaintiff, as standing for the proposition that damages are recoverable only when "gross." Rather, as the District Court correctly points out, damages must be "actual" and reasonably demonstrable, but not the subject of speculation and guesswork.

II.

While Plaintiff is Bound by his Waiver of Trial by Jury, it is Irrelevant to the Outcome.

Since summary judgment for Chase was proper on the undisputed facts, the Court need not tarry over plaintiff's efforts to extricate himself from his jury trial waiver.

Plaintiff's counsel admits that in open court he orally waived his client's demand for trial by jury. Counsel for Chase joined in that waiver, and the consent of both parties

to trial by the Court, sitting without jury, was subsequently entered in the record in the Court's memorandum decision (101a). Indeed, since that decision, plaintiff's counsel has confirmed by motion papers and affidavits also entered in the record (79a, 83a), and again in his brief on this appeal (p. 29), that he made the waiver.

Such a waiver, thus formalized, fully accords with the requirements of Federal Rule 39(a)(1). As such, it is binding upon both parties and neither party may retract it unilaterally. As Professor Moore states, at Volume 5, pages 344.2-344.3, of his treatise on *Federal Practice* (2 ed. 1974):

> "Where withdrawal is made with consent of the parties, the party withdrawing a jury demand cannot change his mind."

Plaintiff cites no authority supporting his request for reinstatement of a jury demand, unequivocally withdrawn in open court and subsequently entered in the record. Where "counsel for both parties had expressed their assent" to withdrawal of a jury demand, such withdrawal was held to be binding in *West* v. *Devitt,* 311 F.2d 787, 788 (8th Cir. 1963).

But even if plaintiff had not waived a jury, judgment in favor of Chase was the proper disposition of Chase's motion on the record before the District Court. Rule 56 applies to both jury and non-jury cases alike.

CONCLUSION

The judgment of the District Court should be affirmed, with costs.

September 24, 1975

Respectfully submitted,

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